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ADDRESS

Before Eleventh Annual Meeting

OF THE

Association of Life Insurance Presidents

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by

S. DAVIES WARFIELD, PRESIDENT

NATIONAL ASSOCIATION OF OWNERS OF RAILROAD SECURITIES

**"Safeguarding the Owners of the Securities of the
Railroads of the Country"**

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ADDRESS OF S. DAVIES WARFIELD BEFORE
ASSOCIATION OF LIFE INSURANCE PRESIDENTS

MR. CHAIRMAN AND GENTLEMEN:

My subject: "Safeguarding the Owners of the Securities of the Railroads of the Country," has a wide range and the time at my disposal will permit me to deal with only its more important phases.

Perhaps no institutions are so vitally interested in this subject as the life insurance companies of the country. Mr. Kingsley in his admirable presentation before the Interstate Commerce Commission in June last told the Commission that twenty-five per cent. of the investments of the life insurance companies consist of the securities of the carriers. One-fourth of the money policy-holders have provided by life insurance for the protection of those who are to come after them, is, therefore, invested in railroad securities. Safeguarding the 33,000,000 policy-holders who are the real owners of these securities becomes a question of vital concern to them.

You represent, perhaps, the greatest investing power in the world. I will not go into figures, with which you are more familiar than myself, excepting to say that the total assets of the life insurance companies of the nation approach \$6,000,000,000; of which approximately \$1,500,000,000 are railroad securities. No set of men managing any institutions have more thoroughly at heart the interests of those dependent upon them. Your presidents are representative of the greatest executives we know of. Your general agents throughout the country represent a high type of citizenship and ability, the agents tributary to them possess the confidence of their communities and come in frequent contact with the policy-holders

of their companies. You have one of the greatest systems for agency work in the world; representing 46,000,000 policies, owned by the thirty-three million people, over one-fourth of the population of the United States, and constituting the machinery for educational work unsurpassed. You have, therefore, the most effective means for securing the co-operation with you and with the National Association of Owners of Railroad Securities of this vast army of interested policy-holders to assist in carrying out the purposes of our Securities Association, which are to protect and stabilize railroad securities.

I am well aware that the life insurance companies hitherto have hesitated to discuss questions, through their agents, with the holders of their policies, other than those which have to do with the current affairs of their respective companies. But in this crisis in the affairs of the railroads, in the solidity of which every holder of a life insurance policy is so much concerned, the question of how to bring home to your policy-holders the realization that they are the real owners of these securities, pointing out the difficulties under which the carriers which issued them are laboring, and securing their co-operation, has received the earnest consideration of the presidents of many of the great life insurance companies. Some have already taken steps to this end.

This is a great public question and we must so treat it. Full knowledge of these difficulties on the part of so large a proportion of our people, together with the work we propose, should help to a satisfactory solution of the problems involved.

It is not that the real or intrinsic value of railroad securities generally has depreciated, for it has not; on the contrary, the railroads are showing the greatest gross earnings in their histories, but in most cases with less net revenue. They have the business, but the system under which they are permitted to operate has restricted the application of ordinary business

methods causing this shrinkage in their net earnings. This must be corrected. That it has not already been is largely because of a misconception on the part of the public of the true meaning of regulation as it applies to the railroads. This condition has really arisen from a hostile attitude towards the carriers, perhaps the result of autocratic railroad managements in the past and the exploitation of certain railroads, which we are convinced will not happen again.

This attitude has found expression through Congress, legislatures and regulatory bodies, with the result that either through laws enacted, or by regulations laid down, the railroads find themselves in a position never before occupied by any other enterprise in this or any other country.

The real value of railroad securities will be seriously affected only when the public has become fully convinced that governmental agencies of regulation and control have determined upon a fixed policy towards the carriers, which fails to recognize that the rights of those who own their securities demand, at least, equal protection with that accorded the shippers and others who use the railroads.

Conditions for some time have been intolerable. We must face them. I know of no extreme condition of equal importance that the American people have not finally solved and solved properly.

It was because of just these conditions that the National Association of Owners of Railroad Securities was organized. One of our objects, as announced by the Association, is to endeavor to have policy-holding owners, as well as other owners of these securities, understand to what extent they are concerned in any adverse action by governmental agencies, through legislation or otherwise, affecting the railroads which issue them. Unless we have the support of security owners we cannot expect to secure results.

The co-operation given the Securities Association by the life insurance companies is exceptional, and let me say it was largely because of this co-operation that I felt willing to assume the responsibilities of the presidency of the Association. For I keenly feel the responsibilities of the work we have undertaken and the position occupied by me in its accomplishment.

It may interest you to know that the following life insurance companies are now members of the Securities Association:

New York Life Insurance Company,
Mutual Life Insurance Company,
Metropolitan Life Insurance Company,
Equitable Life Assurance Society of the United States,
Prudential Insurance Company of America,
Mutual Benefit Life Insurance Company,
Penn Mutual Life Insurance Company,
Travelers Insurance Company,
New England Mutual Life Insurance Company,
Home Life Insurance Company,
Fidelity Mutual Life Insurance Company,
Berkshire Life Insurance Company,
Life Insurance Company of Virginia,
Northwestern National Insurance Company,
Maryland Life Insurance Company,
Scranton Life Insurance Company.

We are receiving effective support also from individuals, financial and other institutions throughout the country, including savings banks. The President of the American Bankers

Association, and the President of the Trust Company Section of that Association, are now, by personal communications, securing membership for our Association. Personal solicitation, however, will be necessary if we are to secure the full measure of success in the direction of membership.

Taking into consideration the number of policy-holders of the life insurance companies and the depositors of mutual savings banks, now members, and individual members, exclusive of membership represented by financial and other institutions, owned by stockholders, our Association represents a total membership of approximately 26,000,000 people, out of the 50,000,000 who directly or indirectly own railroad securities.

So large a representation of interested people should be considered in matters affecting them, especially when those who have provided for their families by insurance on their lives constitute so great a number.

One cause for present conditions may be because railroad executives have not impressed earlier on those in authority over the carriers the acute condition of their credit, and also informed their security holders of all the facts. This was perhaps natural, for a man may hesitate to make public what he feels may affect those who have purchased the securities of the enterprise he represents. Nevertheless, it has been only recently when the real facts have been brought forward, that we seem to have impressed the public and some of those in control, that an impasse was reached some time ago, and it had become difficult to advantageously market railroad securities. It was already known that sufficient earnings could not be obtained by the railroads to properly maintain their properties and thus protect their securities, and to provide proper operating and permanent facilities. How far the activities of our Securities Association have already contributed to this result you are able to judge. It is not necessary to go into the

details which led to calling together security holders of the carriers and later for representatives of the Association to appear before the Interstate Commerce Commission and set before them and the public, for the first time, the real conditions of credit of the railroads. The representations then made have been justified by existing conditions. The security holders decided for themselves that the time had arrived for the true conditions to be made known and acted accordingly.

To illustrate the necessity for educational work in connection with this subject I might call attention to a communication received in August last, from a prominent member of our Association, who is giving us his hearty support. He intimated that the newspaper accounts of railroad earnings indicated that they could now get along without increased rates, and our work was therefore nearly accomplished.

Let us see how far we are from the accomplishment of our purposes. The fact will not now be controverted that a crisis has been reached in the affairs of the railroads. Present conditions cannot continue. The carriers have arrived at a state of such demoralization, both in respect to their operations and their credit, that it is apparent we have reached the point where either a satisfactory plan must be formulated, by which, under Federal regulation, they may be successfully operated through private ownership, or the Government will take them over, as much as we may be opposed to it, and probably at a valuation below their intrinsic worth.

The Interstate Commerce Commission have just made a special report to Congress in which it is held that increase in rates will not solve the immediate situation, throwing upon Congress the responsibility of relieving existing conditions as an expedient of war. This does not solve the fundamental problems of the carriers based as they are and will always continue to be, at least so long as the railroads are operated through private owner-

ship, upon the proper adjustment of rates. This is a question based on economic law which must be met either now or later by Congress or the Commission.

One of the difficulties of the situation lies in the fact that the Act of Congress under which the Interstate Commerce Commission operates has apparently been construed by the Commission as having been planned for the *restriction* of the railroads. This Act was subsequently amended so as in effect to nullify the initiative of the railroads in making rates. This was done without clearly specifying that it is a *duty* of the Commission to protect the carriers and their revenues in the interest of the transportation welfare of the country, not merely to act in a restrictive capacity. In fact, in their special report the Commission have gone the length of stating that the Act "looks to the protection of the shipper and the public against unjust or unfair treatment by the carriers." Having practically taken control of the operations of the carriers the Commission should have also assumed the responsibility of exercising ordinary business foresight and precaution to have enabled the carriers to at all times meet the changing conditions which confront them. Had such a policy been pursued Congress would not now find the responsibility forced upon them of solving the present difficulties. It is vital, either that the Commission should clearly recognize this as a most important part of their duty under the law, or that Congress amend the Act and imposed upon the Commission this obligation and direct its exercise, leaving no ambiguity as to its purpose.

Deciding as to the "reasonableness" of one rate or another without taking into consideration the full effect of their operation on the enterprise which must depend upon them should not be the principle controlling the action of the Commission. The fact must not be overlooked that the Act calls for rates to be "*just*" as well as "*reasonable*." From the Commission's

report it seems to be the purpose of the Commission even though the Government should act on their suggestion to make loans to the railroads to continue in future regulation of the carriers of the country under the narrow construction they have hitherto placed upon the Act. If this is the purpose of those who are charged with the responsibilities of regulation as members of such a commission, disaster will follow and regulation by commission will become a failure. This would be unfortunate. We all believe in the regulation of the carriers.

The policy which has been pursued up to the present has brought the railroads where they now find themselves; not only are their net earnings, as frequently pointed out, insufficient for their proper maintenance and successful operation, but, in addition, they are now confronted with the competition of the Government in the sale of their securities, upon which they must depend for their very existence. Next to the owners of these securities, the shippers have been the greatest losers although many have never seemed to realize it, for their business has been affected adversely as their facilities have been contracted. The question now is what is to be done in the immediate future.

Government loans to the railroads are suggested. This, if adopted, is only a measure of temporary expediency. Such loans now seem necessary, to tide over present difficulties. But if the railroads are to be permitted to be operated like every other business enterprise, they can only be successful and sound financially by allowing them to charge for their products—hauling freight and passengers—such an amount over the cost of doing business as will ensure their soundness and success. Under Government ownership if they were not so operated the people would pay for it in the end. Such advances as the Government may make to the carriers, if they are made, should not be in such form as to be the forerunner of governmental ownership.

If done, I hope it will be through an equipment company to be organized, to which such loans may be made. This company to purchase equipment to be leased to the railroads. I will discuss this later.

One crucial point must be definitely settled, and by legislation, before any satisfactory solution can be had of the railroad problem. This question is: how in the making of rates under existing conditions is the Interstate Commerce Commission to treat carriers operating in thin or partially developed territories which are in competition with other carriers operating in better or more fully developed sections. It matters not in which of the three or four subdivisions of the country, usually considered in the making of rates, such railroads may be operating.

For example: railroads are operating in thinly developed territories. Their securities have been sold in good faith and the public own them. Necessarily they have not been sold as advantageously as the securities of carriers operating in developed sections. It is recognized that merchants and others doing business in thin territories must secure higher prices for their goods or products than those in similar lines of business in developed sections. The basis of nearly all operations in thin territories entails higher cost than in developed sections. You cannot adjust freight rates accordingly; if you do, unless all railroads in competitive territory are included, the railroads securing higher rates would lose business. It would go, of course, where the rates are lower. This policy, therefore, cannot be pursued. If rates are all adjusted to meet the needs of thin territories, railroads more favorably situated will earn a proportionately greater amount, perhaps such an amount as will cause their shippers to oppose such increase in rates. Then the shipper in thin territory, not recognizing his own situation, also opposes. Such shippers who join with those in developed sections in opposing properly adjusted rates stand in their own light. They are

more dependent upon adequate transportation facilities than those located in developed sections because more in need of them.

Various methods to meet this situation have been suggested, but none, so far as I am aware, fully does so. Federal Incorporation will not solve this problem; it has no relation to it, and was not intended to have. Federal Incorporation would bring the railroads closer to Government ownership, and apart from the doubtful constitutionality of questions incident thereto it would likely take from them valuable rights they now possess, and which as formerly pointed out should not be sacrificed. Certainly no such chances should have been taken unless and until the position of the railroads was first definitely and firmly fixed.

It has been suggested that the country be divided into regional districts somewhat similar to the Federal Reserve System, and the carriers of these districts consolidated into a single corporation in each district, not so much for the purposes of regulation as for the purposes of operation. This would call for the repeal of existing legislation, dealing with railroads, in practically every state and in the enforcement of Acts depending for their constitutionality upon the unanimous consent of all the stockholders of the railroads. It may be possible to work out something on these lines, but such a plan would probably involve great opposition, and the time and readjustment of rights entailed in its accomplishment would seem an insuperable obstacle, certainly at this time. A question to be considered is, since the expressed purpose of this plan is to create companies to monopolize given territories does this not summarily end competition, very necessary for the future development of the country. The transportation lines of the country cannot be compared with street car lines operating in cities. This country has hundreds of millions of acres of undeveloped territory, which should be brought into service, and especially at this time of urgent

appeal to help feed ourselves and our allies. Any plan which might prevent, or retard even, the development of our country and stop the initiative in human endeavor would not seem to be to the best interests of the people at large. Unless the Government should guarantee in some form the securities of such a company, might not ownership by the Government be the logical result.

Another plan suggested, provides that freight rates are to be adjusted to enable all the carriers to earn a fair return, and an excess profit tax levied or a tax levied in similar manner on the net revenues of each carrier over and above the amount of profit each is to be allowed, as may be fixed by Congress or as determined by the Interstate Commerce Commission. These excess earnings, we will call them, would go either to the Government or into a fund to purchase equipment to be leased to the carriers.

I have seen a table which has been prepared, figured on an increase in rates sufficient to produce an increase of 20% in the revenue of railroads. This, after allowing a fair return to all the carriers on their property investment, would result in turning into this fund, approximately \$300,000,000, based on gross earnings and cost of operation for the year ending June 30, 1915, and before the advent of present high cost of materials and railroad operation. Public and governmental opinion place a limit on the profits that may be earned by the more favorably situated railroads. The Interstate Commerce Commission is unwilling to allow this profit to be increased, they have made this clear repeatedly. The increase suggested presents, we will say, a fair increase for the less favorably situated railroads—the perhaps 80% of the railroad mileage and service. While it may be said that the other 20% do not need this increase, it must be admitted that the 80% do need it. Apparently the only way under present conditions by which the 80% can secure the needed increase without enabling the 20% to earn more profit than

the Commission think they should earn is by levying an excess profit tax on the increased profits which would fall more heavily on the more favorably situated railroads due to the increase in rates suggested. Excepting through the operation of a plan of this description, carriers would not have received the earnings they thus contribute to this fund; and the railroads which contribute the most thereto should be proportionately benefited as suggested later. The tax under which these earnings are derived is graduated, and the carriers would receive certain benefits from this increase in rates they would not have received otherwise. They are also benefited in the distribution to them of equipment purchased from the fund to which they contribute. And while shippers have had their rates increased, it comes back to them in greatly increased shipping facilities supplied without additional later cost to them. Transferring the capitalization incident to the purchase of equipment to be leased to all of the railroads from the railroads to an equipment company would eventually work towards a reduction in railroad rates.

Under such a plan an equipment company would be incorporated with two classes of capital stock—voting and non-voting. The Government to loan to this company sufficient money to purchase equipment necessary to supply the requirements of all of the railroads. As collateral for such loans the Government to receive equipment bonds of the equipment company secured by the usual equipment trust. These bonds would mature in say 20 years, with sinking fund provisions which would at maturity retire the respective loans of the Government or the Government may purchase the bonds. In consideration of such loans or purchase the Government to receive sufficient of the voting stock (non-dividend paying) to control the equipment company.

The money derived under this excess profit tax plan would be paid to this company at stated periods, and non-voting stock

issued to the railroads in proportion to the excess profits so paid and on such a basis as may be determined. Arrangements might permit carriers to turn over to this company such equipment as may be released from mortgages and equipment trusts and be paid the value thereof, partly in cash, the balance in non-voting stock. The earnings of the equipment company would be certain, through the graduated per diem paid by the railroads for the use of the equipment. Furthermore, the amount of revenue of this company to be used in its operations including the purchase of equipment is susceptible of adjustment through the excess profit tax mentioned. The company would be managed by a board of railroad experts similar to the present board now directing the distribution of cars to the railroads to be appointed by the President. If stock should be sold to retire Government loans or for the other purposes of the company it would have representation also on this board. The equipment would be distributed to the railroads in such amount and to such localities as would best serve the purposes of the Government in time of war, and the purposes of business interests, and the public generally, in time of peace.

The amount of money invested by all the railroads of the country in equipment during the past nine years as far as ascertainable approximates \$1,221,000,000; the amount of equipment obligations of all the railroads as of December 31st, 1916, is \$428,168,579; the annual payment thereon by all the railroads as of that date is \$71,516,779.

Such a plan would therefore liberate a large amount of money to be used by the railroads in the expansion of their general facilities, including terminals, would reduce railroad capitalization, and in effect would restore the benefits of the principle of pooling to all the railroads alike and not to the exclusion of the smaller or weaker roads, and now found to be necessary for effective and economical operation. Complaints

constantly made against carriers by shippers in not securing adequate supplies of cars, would be reduced. The responsibility would here be fixed. The operation of such a company might be extended to cover the acquisition of certain classes of terminals for the railroads, such as co-operative port facilities somewhat similar to highly developed port facilities in Europe, supplied outside of the railroads themselves.

The difficulties met with in rate adjustments and the benefits of the application of an excess profit tax plan may be illustrated by the cases of the Pennsylvania Railroad and the Baltimore & Ohio main lines. The former operates its entire length through a densely populated and highly developed industrial region, with large natural resources, both agricultural and mineral, to feed it. The latter, after leaving Washington and until it reaches Wheeling, a distance of 360 miles, runs through a region which in development cannot be compared with the former. The census of 1910 shows Pennsylvania to have 146 incorporated places of 5,000 inhabitants and over, with Philadelphia, Pittsburgh, Harrisburg and other cities, whereas Maryland and West Virginia have only 20 between them, the largest, outside of Baltimore, being Wheeling with 41,641 people.

Nevertheless, the Baltimore & Ohio has to maintain tracks and shops which must be laid and erected primarily with regard to mileage and secondarily with regard to density of business; also to maintain freight cars, and equip passenger trains to run in competition with its richer rival, otherwise all traffic that is at all competitive will drift from it; its service will deteriorate, and the communities along its tracks which are *fixed* will suffer both in property and convenience. In rate adjustments, should the interests of the B. & O. communities be sacrificed simply because there are more numerous and extensive communities elsewhere? Communities in such territories should insist on adequate rates to secure them facilities to compete

with their richer neighbors instead of showing the hostile attitude often exhibited. Why should parts of the country receive a set-back because other parts happen to be more densely populated and more highly developed?

The illustration exemplifies the principle that it is the railroads operating in sparsely settled communities which must be the controlling factor in rate adjustments and not the more favored roads. The territory in which they operate needs satisfactory rates the most. Increase in basic cost of operations applies equally to both.

An excess profit plan would break the deadlock. The adjustment of rates to the needs of the latter would result in turning into the fund mentioned the excess profits of the former. Mr. Rea and Mr. Willard, presidents of the properties mentioned, are considered among the foremost railroad executives of the country. Therefore, questions will likely not be raised as to the proper operation of these two properties. Even if the Government should take over the railroads it would have to find the money to support the lines operating in thin territories. A plan of this description would stabilize the securities of the carriers; it protects them without formal guarantee on the part of the Government.

It might settle questions of the physical valuation of railroad properties now in progress by the Interstate Commerce Commission. The difficulties of railroad operation such as have been shown may enable Congress or the Commission to arrive at a fair basis of earnings for the respective railroads in considering the adjustment of rates incident to the effective operation of such a plan. And they should take into consideration the increased cost incidental to building and operating railroads in undeveloped territories, in any valuation of a railroad property which might be thought necessary in finally adjusting basic rates. A plan of this description may be the basis for the quick

solution of present difficulties. It may furnish the means as a war measure to quickly adjust rates to meet the exigencies of the situation and rapidly create a fund to be used to immediately furnish the equipment and additional facilities so necessary to the proper conduct of the war and the business of the country.

Questions of control of intrastate rates, to prevent them from substantially burdening or interfering with the interstate system of rates, as well as the question of the exclusive control of the securities of the carriers by the Interstate Commerce Commission, which I have dealt with at other times, are details in comparison with the importance of the adjustment of the fundamental difficulties I have mentioned. No solution of the problems of the railroads can be had until these fundamentals are satisfactorily provided for. Bills can be prepared to effectively care for questions of intrastate rate and securities control. In fact, so far as intrastate rates are concerned, the Supreme Court has already shown the way.

On the occasion of the several opportunities offered me for discussing the problems before us, I have not let any interest I may represent prevent the disclosure of actual conditions and the discussion of suggestions made to correct them. I have viewed the questions at issue from the standpoint of the public only, and for the best interests of the country at large. No criticism or reflection in any quarter or direction has been intended. I conceive one of the duties of the position occupied by me as President of the Securities Association is to present all the facts and suggestions made, for public discussion. I have no specific plans to propose at this time and no interest to serve other than to stabilize and protect the owners of the securities of the carriers, and help to reach a wise solution of this great public problem.

The necessity for action in a constructive as well as a pro-

tective capacity, and in legislative in addition to regulatory fields is so apparent that I have preferred to point out some of the problems we face and the difficulties confronting us, rather than attempt to enumerate in detail the obvious purposes of the Securities Association in safeguarding the owners of railroad securities. The field is limited only by the extent of our ability to cover it. The position just taken by the Interstate Commerce Commission makes more important the work of the Securities Association.

In the recommendations made to Congress by the Commission no suggestion is made for the protection of the security holders of the carriers and their income, or to protect the Life Insurance Companies and other fiduciary institutions which own railroad securities, excepting only that if the property of the carriers shall be actually taken from them, in such case they must be compensated for its use. Readiness for collective action to meet the present situation and other questions as they arise is the immediate necessity. And with no purpose of criticism, we should be unwilling to leave entirely to the operating heads of the railroads the sole decision of questions of such vast magnitude now before Congress and before the country; and they should not wish to assume any such responsibility, independently of those who own their securities and whom the National Association of Owners of Railroad Securities more than any other agency represent. We must avoid being stampeded under some excuse of war necessity possible to be disseminated for the purpose of carrying out some favored operating plan; those who own the securities of the carriers should be permitted to be the judge of its effect upon them. It has taken the exigencies incident to war preparation to bring the railroads to realize that co-operative action on the part of their executives is essential to efficient operation. Let the security holders profit by this experience and prepare for action by joining with us in the work we have before us.

The railroads will not emerge from the war as they existed before it. Your securities may bear altogether a different relation to the properties which issued them. The world is going through the greatest upheaval and change since its beginning—it affects more people. So are the railroads. We should prepare for it. Representatives of all interested, co-operating with the Government, can accomplish lasting results and this can be done only by sinking individuality and by avoiding the temptation to take some action which may lead to some personal preferment or the adoption of some personal plan rather than that which will further the best interests of the country and all concerned. There never was a time when statesmanship in railroad management as well as in Congress is so needed, and unselfishness in all directions so essential. To win this war the approaches to it must be born of the realization that we are bound together as one against a common enemy and we must wipe the slate clean, forget past animosities and start afresh. The railroads are vital to the proper conduct of the war. Their problems should be solved and with due regard to those who have supplied the money to build and operate them, namely, the 50,000,000 people who directly or indirectly own the securities of the railroads of the country.